Hudson's Bay Oil and Gas Company Limited

Annual Report

FOR THE YEAR ENDED DECEMBER THIRTY-FIRST

1959

THE YEAR IN BRIEF

	1959	1958
FINANCIAL		
Gross Income	$21,329,000	$19,925,000
Net Income before Special Credits		
Total	$ 2,821,000	$ 1,316,000
Per Share	$ .16	$ .07
Special Credits	$ 943,000	$ 2,472,000
Net Income for Year	$ 3,764,000	$ 3,788,000
Expenditures for Finding and Developing Reserves	$17,849,000	$17,913,000
OPERATING		
Crude Oil Production — Net (Barrels Daily)	21,144	20,099
Natural Gas Sales Volumes — Net		
(Millions of Cubic Feet Daily)	47.915	14.364
Exploratory and Development Wells Completed		
Gross	185.0	192.0
Net	101.3	102.2
Acreage at December 31 — Net		
Fully or Partially Developed	135,000	125,000
Undeveloped	11,407,000	10,022,000
Total	11,542,000	10,147,000

Board of Directors

L. F. McCollum, Chairman, Houston, *President and a Director of Continental Oil Company*

P. A. Chester, Vice-Chairman, Winnipeg, *formerly Managing Director of Hudson's Bay Company*

Ira H. Cram, New York, *Senior Vice-President and a Director of Continental Oil Company*

Joseph Harris, Winnipeg, *Chairman of the Board of Directors of The Great-West Life Assurance Company and a Director of Hudson's Bay Company*

Herbert H. Lank, Montreal, *President and a Director of Du Pont of Canada Limited*

G. T. Pearson, Calgary, *President of the Company*

Chas. A. Perlitz, Jr., Houston, *Executive Vice-President and a Director of Continental Oil Company*

L. J. Richards, Calgary, *Senior Vice-President of the Company*

James A. Richardson, Winnipeg, *Vice-President and a Director of James Richardson & Sons Limited*

J. E. Woods, Winnipeg, *President of the Monarch Life Assurance Company and a Director of Hudson's Bay Company*

Officers

G. T. Pearson, President

L. J. Richards, Senior Vice-President

Howard W. Blauvelt, Senior Vice-President

Glenn H. Bowes, Vice-President, Exploration

K. H. Burgis, Financial Vice-President and Treasurer

E. L. Shafer, Vice-President, Production

F. J. Mair, Controller

R. Suttill, Secretary

Head Office

320 Seventh Avenue West, Calgary, Alberta, Canada

Transfer Agents and Registrars

Montreal Trust Company, Calgary, Toronto and Winnipeg

Morgan Guaranty Trust Company of New York, New York

Hudson's Bay Oil and Gas Company Limited

REPORT TO THE SHAREHOLDERS

THE YEAR'S RESULTS

Net income of Hudson's Bay Oil and Gas Company Limited and subsidiaries, before special credits, was $2,821,000 or 16 cents per share in 1959. This represented an increase of $1,505,000 over the comparable net income of $1,316,000 or 7 cents per share earned in 1958. The improvement was principally attributable to an increase in sales of natural gas and a reduction in the cost of unsuccessful wells drilled. Special credits brought final net income to $3,764,000 in 1959 and to $3,788,000 in 1958.

Net production of crude oil averaged 21,144 barrels daily during the year, an increase of 1,045 barrels daily or 5.2% over 1958. This increase was considerably smaller than the gain of 11.4% achieved by the petroleum industry as a whole in Western Canada. The expansion in the Company's production was held down by the unfavorable effect of a change in the method of allocating demand for crude oil among the various producing fields in Alberta. Proposed construction of pipe line connections to shut-in reserves and recently completed pressure maintenance systems should help to maintain the Company's production in the future.

Sales of natural gas averaged 47.9 million cubic feet daily compared with 14.4 million cubic feet daily in the prior year. This sharp increase reflected a full year's sales from facilities which went into operation in the fall of 1958 upon completion to Eastern Canada of the natural gas pipe line system of Trans-Canada Pipe Lines Limited. The Company's sales of natural gas will more than double over the next few years if approval is given to pending applications for exports to available markets in the United States.

The highlights of the Company's exploratory effort in 1959 were a significant extension of the Virginia Hills crude oil field in North Central Alberta, a promising crude oil discovery in the Milligan Creek area of Northeastern British Columbia, and the acquisition of large holdings of undeveloped acreage in the Northwest Territories. Early in 1960 an exploratory well drilled near Fort Nelson in Northeastern British Columbia encountered 359 feet of gas-bearing Devonian reef, the thickest producing reef section found in the area to date.

The value of the Company was enhanced in 1959 by additions to proved reserves of hydrocarbons. Discoveries, extensions, and revisions of such reserves substantially exceeded production during the year. Expenditures for finding and developing reserves, inclusive of both capital and expense items, were $17.8 million in 1959, virtually the same amount as in the prior year.

INDUSTRY PROBLEMS

In 1959 the petroleum industry in Western Canada spent approximately $610 million to find and develop new reserves of hydrocarbons. This rate of spending was down about 5% from the peak reached in 1956 and was only slightly above expenditures in the recession year of 1958. The 1959 level of activity reflected the failure of market growth to keep pace with the industry's capacity to produce.

Production of crude oil in Western Canada was restricted to approximately 50% of capacity in 1959, primarily by competition from foreign crudes moved to market at abnormally low tanker rates. Production of natural gas was limited to less than 35% of potential capacity during the

year. In contrast to the crude oil situation, demand for large volumes of Canada's natural gas existed in foreign markets. Access to these markets is dependent upon clarification and implementation of national policy regarding exports.

During 1959 Western Canada's crude oil production regained the ground lost in 1958. Average output of 503,000 barrels daily increased 11.4% over the prior year. Production for domestic use averaged 412,000 barrels daily, up 12.3%, and exports averaged 91,000 barrels daily, up 8.3%. Slightly less than half of the improvement in production for domestic use was attributable to an increase in consumption of refined products; the remainder was attributable to displacement of foreign crudes and products in the Ontario market. The major portion of the benefit from larger volumes of production was cancelled by general price reductions, which averaged about 14 cents per barrel for the year.

The Royal Commission established by the Canadian Government to investigate the country's energy resources submitted a report in August, 1959 dealing with crude oil marketing problems. In this report the Commission expressed the opinion that the industry could, without government intervention, achieve a production level of 700,000 barrels daily by the end of 1960. Accordingly, the Commission recommended that no government action be taken until the industry had first exerted every effort to find additional markets in Canada and the United States sufficient to sustain a healthy level of activity. In the six months since the Commission issued its report, crude oil production in Western Canada has averaged approximately 526,000 barrels per day.

During the 1959 session of Parliament a National Energy Board was established to regulate the country's energy resources, including natural gas. This Board commenced hearings in January, 1960 on five applications for natural gas exports aggregating 880 million cubic feet per day. It is of vital importance to the welfare of the industry that exports of natural gas in large volume be approved.

A LOOK AT 1960

With the current high level of general business activity, further improvement in the level of crude oil production in Western Canada can be expected. The degree of improvement, however, may be less than that experienced in 1959 when a significant volume of foreign crude was displaced in the Ontario market.

Early approval of natural gas exports on practicable terms would act as a spur to construction of new pipe lines and allow the commencement, late in 1960, of natural gas deliveries to the midwestern area of the United States. Also, the opening-up of additional markets would stimulate the search for natural gas in Western Canada and accelerate the development of existing natural gas reserves.

The Company's present plans call for continuation in 1960 of the recent level of spending for finding and developing reserves of crude oil and natural gas. Emphasis will be given to the acquisition and evaluation of exploratory acreage to assure continued growth of reserves, but some development expenditures may be deferred until currently depressed market conditions improve.

A broadened and liberalized program of benefits for employees was adopted by the Company in 1959. This program is designed to assist in attracting and retaining employees of superior skills. It is practical recognition that employee performance is the most important single factor in determining the success of the Company's operations.

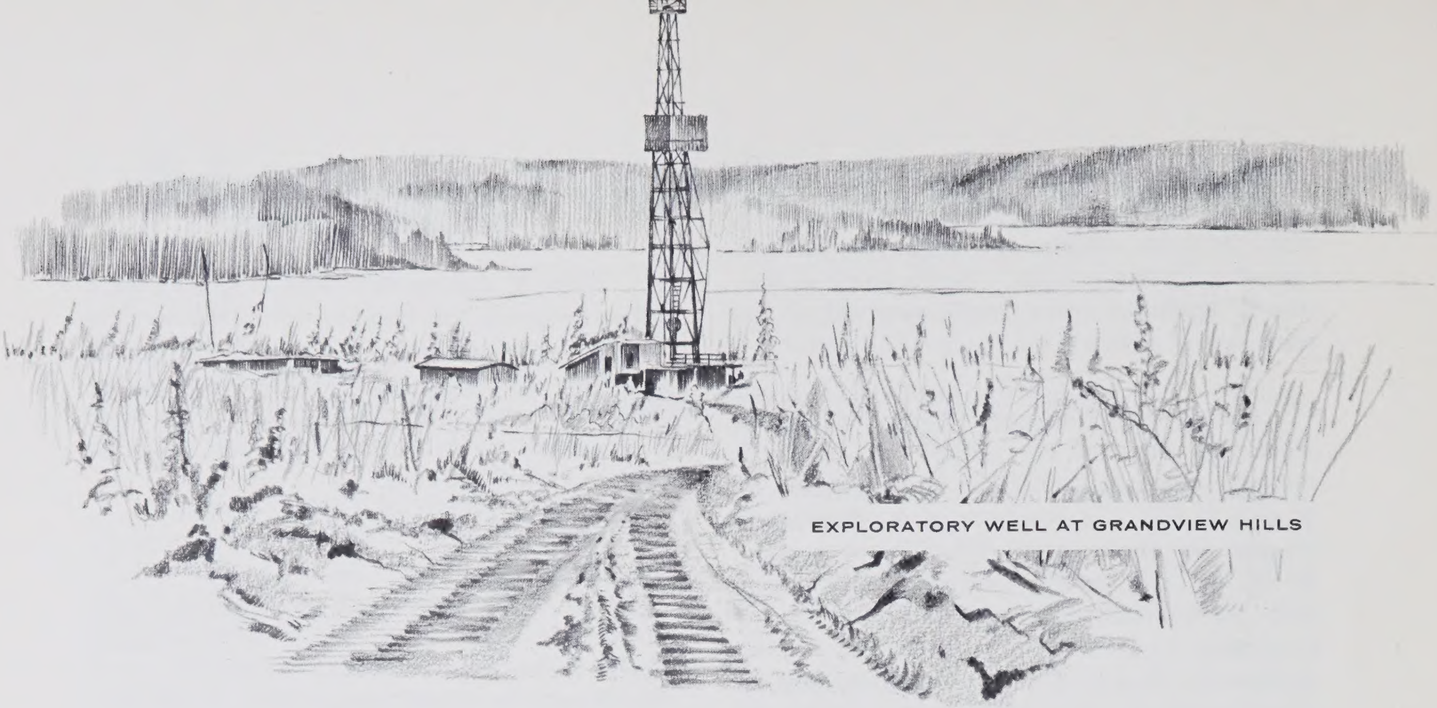
Additional operating and financial information is given in the general review which follows.

Submitted on behalf of the Board of Directors:

G. T. Pearson

President

Calgary, Alberta
March 2, 1960



EXPLORATORY WELL AT GRANDVIEW HILLS

GENERAL REVIEW

EXPLORATION

General — During 1959 the Company continued to emphasize exploration for new oil and gas reserves. All phases of exploratory effort were carried on in the major prospective areas of Western Canada, principally in the provinces of Alberta, British Columbia and Saskatchewan. Late in the year activity was extended into the Northwest Territories where major projects were undertaken in the Arctic Red River and Grandview Hills areas north of the Arctic Circle.

Discoveries — During the year HBOG participated in 11 discoveries and 1 field extension. A summary of these discoveries and extensions is given in the table at the bottom of the page.

DISCOVERIES AND EXTENSIONS IN 1959

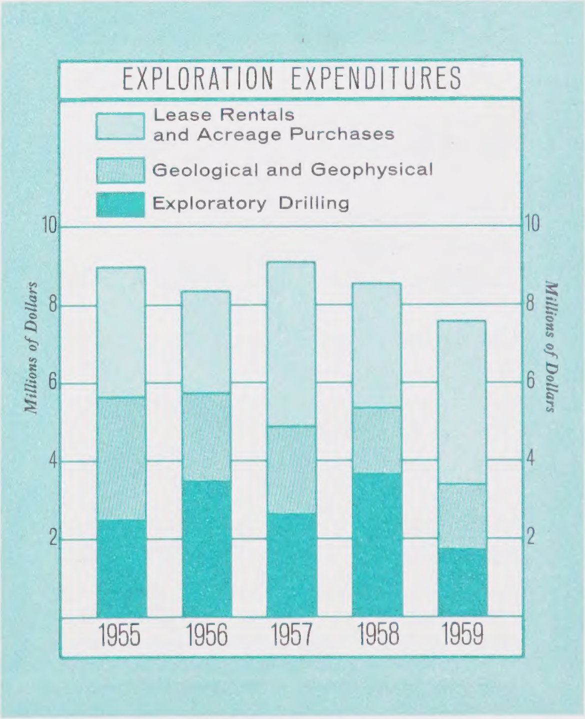
Name of Field or Area	Discoveries and Extensions Number	Discoveries and Extensions Nature	Producing Formation	Approximate Depth
Virginia Hills	1	Crude Oil	Devonian	9,200′
Milligan Creek	1	Crude Oil	Triassic	3,700′
	1	Natural Gas	Triassic	3,700′
West Whitecourt	1	Crude Oil	Devonian	10,800′
	1	Gas-Condensate	Cretaceous	7,300′
Wintering Hills	4	Crude Oil	Cretaceous	4,500′
	1	Gas-Condensate	Cretaceous	4,500′
Eaglesham	1	Crude Oil	Devonian	7,600′
Dickson	1	Crude Oil	Cretaceous	7,500′

At Virginia Hills, 125 miles northwest of Edmonton, an extension well encountered 109 feet of oil-bearing Slave Point reef of Devonian age at a depth of 9,200 feet. This well, located on a block of leases in which the Company owns 3,157 net acres, extended the productive area of the field 3½ miles to the southeast. The Company is operating 5 drilling rigs to develop the reserves in this field. Production can be moved to market through a pipe line which was constructed into the area during 1959.

In the Milligan Creek area of Northeastern British Columbia, where the Company has an interest in an important oil field, 2 successful exploratory wells were drilled on a block of 50,000 acres owned 50% by HBOG. A well, located 1½ miles southeast of the existing oil field, discovered natural gas in a Triassic formation at a depth of 3,700 feet. Another well, drilled 5 miles southeast of the gas discovery, found crude oil in a Triassic sand at a depth of 3,700 feet. On test, this well produced 41° gravity crude oil at a rate of 167 barrels per day. Peace River Oil Pipe Line Co. Ltd. plans to extend its crude oil pipe line system into this area of British Columbia. This extension would enable the Company to increase its production, since only limited volumes of crude oil are now moved from the area during the winter months when local markets are accessible by truck.

In the West Whitecourt block, where large reserves of natural gas and related products have been proved, further exploratory drilling resulted in a natural gas discovery and an oil discovery. At South Kaybob, in the north central part of the block, natural gas was discovered in a Cretaceous sand at a depth of 7,300 feet. At Marlboro, in the southeast part of the block, crude oil was discovered in a Devonian reef at a depth of 10,800 feet. The West Whitecourt block comprises 600,000 acres of leases and reservations, in the greater part of which the Company owns a 41⅔% interest.

Early in 1960 an exploratory well, located near Fort Nelson in Northeastern British Columbia, encountered 359 feet of gas-bearing Devonian reef at a depth of 6,200 feet. This well, which probably extended the Clark Lake natural gas field 5 miles southwesterly, was drilled in the southeastern sector of a 517,200 acre block of permits. The Company has a 30% interest in the 231,700 acre permit on which the well was drilled and a 20% interest in the remaining permits. The results of previous drilling in the area by the Company and others had been highly encouraging; however, this latest well has greatly enhanced the prospectiveness of the Company's acreage. Further exploratory drilling is planned on this block of permits in 1960.



Acreage Holdings — During the year 2,107,700 acres of undeveloped lands were acquired, and 717,700 acres were released. The latter figure included 536,400 acres surrendered, in accordance with provincial regulations, upon conversion of reservations and permits to petroleum and natural gas leases. Reflecting these transactions, the Company's undeveloped land holdings in Western Canada totalled 11.4 million acres at the end of 1959, compared with 10.0 million acres at the previous year end.

A major portion of the new exploratory acreage acquired by the Company is located in British Columbia and in the Northwest Territories. A 21¼% interest was acquired in permits covering 3,465,500 acres located in the Arctic Red River and Grandview Hills areas of the Northwest Territories. Late in 1959 an exploratory well was commenced on the Grandview Hills block at the northernmost drilling location ever made in Canada.

During the year the Company acquired 189,000 acres of permits in the Athabaska tar sands in Northeastern Alberta. The potential of the permits will be evaluated by a core hole drilling program. Although the existence of large reserves of crude oil in the tar sands has been established, a commercially feasible method of extracting and processing these reserves has yet to be developed. The Company is participating in a research project in an effort to find an economically attractive method of recovering these heavy crudes.

The details of undeveloped acreage held at December 31, 1959 are given in the table at the bottom of the page.

UNDEVELOPED ACREAGE HOLDINGS

December 31, 1959

Type of Holding	Alberta	Saskat-chewan	British Columbia	Other	Total
Option to Lease Hudson's Bay Company Lands	1,414,200	2,338,100	6,100	699,800	4,458,200
Crown Reservations or Permits (1)	419,100	294,500	2,819,500	900,300	4,433,400
Options to Lease from Others	92,100	24,800	—	—	116,900
Undeveloped Leaseholds	2,303,700	79,000	4,500	11,400	2,398,600
Total Acres	4,229,100	2,736,400	2,830,100	1,611,500	11,407,100

(1) Convertible into leases to the extent of approximately 50%

DRILLING

In 1959 the Company participated in the drilling of 185 exploratory and development wells which, after deducting the interests of others, were equivalent to 101.3 net wells. This was a decrease of 7 gross wells or .9 net wells from 1958.

Under the exploratory program, 52 gross or 26.9 net wells were drilled on lands in which working interests are owned, a decrease of 3 gross or 3.4 net wells compared with 1958. Successful completions totalled 3.5 net oil wells and 1.5 net gas wells. The Company paid in cash for 17.9 of the total net wells and obtained the drilling of the remaining 9.0 net wells by assigning interests in acreage.

In addition to its direct participation in exploratory wells, the Company supported, with relatively small contributions of cash or acreage, 17 wells drilled by others adjacent to its lands. Altogether, HBOG participated in or supported the drilling of 69 exploratory wells, 8 wells less than in 1958.

In its development program, the Company completed 133 gross wells or 74.4 net wells, an increase of 2.5 net wells compared to 1958. Successful completions totalled 62.9 net oil wells and 6.4 net gas wells. This was an increase of 7.1 net oil wells but a decrease of 2.9 net gas wells compared with the prior year.

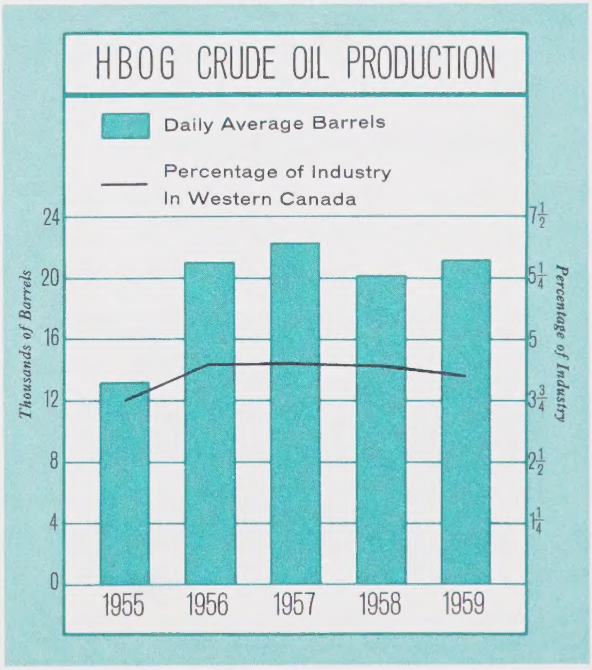
Development drilling was distributed over a number of fields in 1959. The net development wells drilled by fields were: Cessford 14.5; Pembina 10.0; Garrington 8.5; Medicine River 7.5; Innisfail 5.0; Weyburn 4.0; Bellshill Lake 3.3; Milligan Creek 3.0; other fields 18.6.

The cost of unsuccessful wells, principally exploratory, was $2,210,000 in 1959 or $1,075,000 less than in the preceding year. This decline resulted from a smaller number of unsuccessful exploratory wells paid for in cash and a reduction in the average cost of such wells.

PRODUCTION

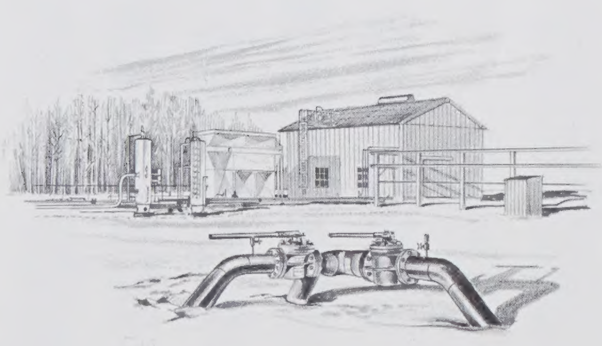
Crude Oil — The Company's net crude oil production averaged 21,144 barrels daily in 1959. This was a 5.2% increase over the daily average of 20,099 barrels produced in 1958.

Production from new wells completed in 1959 and a full year's operation of wells completed in 1958 contributed 2,302 barrels daily to the total production figure. Partly offsetting this increase, there were reductions in well allowables of 418 barrels daily and natural decline in production from older wells of 839 barrels daily.



In the last several years HBOG has instituted several major pressure maintenance projects to increase current rates of production and ultimate recoveries of crude oil. In the Pembina field the Company has installed systems to maintain reservoir pressure under 19,200 net acres by water injection and under 5,760 net acres by injection of natural gas. The installation of similar systems is planned for an additional 4,960 net acres in this field. Results attained to date have demonstrated the effectiveness of these projects in sustaining production, by lowering penalties due to high gas-oil ratios, and indicate that ultimate recoveries of crude oil will be significantly increased. In the Sundre field a system for maintaining reservoir pressure, by reinjecting natural gas produced in association with crude oil, was completed and put into operation early in 1960.

The following tabulation shows daily average net production of crude oil by fields for 1959, with comparative figures for 1958 in brackets: Pembina 7,730 (8,006); Sundre 2,041 (2,158); Sturgeon Lake South 1,400 (1,346); Leduc-Woodbend 1,034 (1,077); West Drumheller 939 (886); Success 762 (788); Fenn-Big Valley 653 (559); other fields 6,585 (5,279).



PRESSURE MAINTENANCE FACILITIES
Sundre Field

Natural Gas and Related Products — Natural gas sales volumes averaged 47.9 million cubic feet daily in 1959, compared to 14.4 million cubic feet daily in 1958. These sales volumes by fields, with 1958 figures shown in brackets, were as follows: Cessford 30.0 (4.2); Pembina 8.4 (1.3); Provost 1.8 (1.3); Viking-Kinsella 1.0 (3.5); other fields 6.7 (4.1).

The increase in volume from the Cessford field was due mainly to a full year's operation of facilities which had been brought into production in the latter part of 1958. The same situation prevailed at Pembina, where gathering and processing facilities were installed in 1958 to comply with a government order to conserve natural gas as a prerequisite to the continued production of crude oil. The decline in volume from the Viking-Kinsella field reflected the lack of firm marketing arrangements in this area. At year end the Company's interest in this field was sold for $711,000, and the resulting gain of $590,000 is included in the income statement under special credits.

Apart from the reserves of natural gas now being produced, the Company has substantial reserves presently shut in but being committed for sale as opportunities arise. Firm contracts have recently been completed for sales of 7.1 million cubic feet daily, most of which will commence in 1960. Additional contracts, contingent on the purchasers' ability to secure export and import permits, have been negotiated for the sale of 40.3 million cubic feet daily. This still leaves the Company with large reserves of natural gas not yet covered by sales contracts.

The largest of these shut-in reserves of natural gas is in the Windfall, Pine Creek, and

Beaver Creek fields in the West Whitecourt block. At this location integrated facilities will be required to produce and market large reserves of natural gas as well as associated liquids and sulphur. As outlined in the 1958 Annual Report to Shareholders, the natural gas from these fields has been contracted to Alberta and Southern Gas Company Limited, with deliveries contingent on the issuance of export and import permits by governmental authorities. Realization of the sales potential from these fields is also dependent on the development of market outlets for natural gas liquids and sulphur. In anticipation of eventual construction of integrated facilities and to secure information regarding reservoir behavior, a pilot cycling plant has been constructed in the Windfall field. This plant has been completed and is undergoing acceptance tests.

PIPE LINES

During 1959 the volume of crude oil transported by Rangeland Pipe Line Company Limited, a wholly owned subsidiary, averaged 22,062 barrels per day, an increase of 24.5% over the previous year. This increased volume was mainly the result of an expansion of gathering facilities in the Innisfail, Garrington, Gilby, and Medicine River fields. The cost of new facilities installed during the year was $743,000, bringing total capital invested in the system to $5,768,000.

To effect economies and simplify administration, HBOG took over the crude oil pipe line properties and operations of Rangeland at year-end and is now conducting these operations as a division of the Company. To effect this change, the Company purchased all of the assets and assumed all of the liabilities of this subsidiary, but maintained the Rangeland corporate entity in an inactive status.

PIPELINE CONSTRUCTION
Windfall

During the year a 46 mile pipe line connection was completed from the Windfall pilot cycling plant to the Edson Station of the Trans Mountain Oil Pipe Line Company system. This connection permits pipe line transportation of natural gas liquids from Windfall to markets on the West Coast. HBOG's share of the cost of this pipe line amounted to $636,000. The engineering and construction of the line were done under the supervision of the Company's pipe line personnel.

In addition to operating the Rangeland crude oil pipe line system and supervising the development of field transportation facilities, the Company's pipe line personnel are responsible for maintaining liaison with affiliated pipe line companies. HBOG owns a 4% equity interest in the Producers-Westspur system and an 11% equity interest in Peace River Oil Pipe Line Co. Ltd. The latter company plans to extend its crude oil pipe line system into Northeastern British Columbia. Construction of this extension would permit HBOG to increase its crude oil production in the Milligan Creek area by approximately 1,500 barrels daily.

EMPLOYEES

During the year management continued to stress the development of policies and programs designed to keep pace with changing economic and social conditions which affect employee welfare and Company operations. Progress was made in the areas of personnel development, communications, and employee security.

As a result of an extensive study of the Company's employee benefit plans, several improvements were put into effect on January 1, 1960. The former home and hospital medical expense plan was replaced with a new comprehensive medical expense plan which provides much broader coverage. The group life insurance plan was revised to increase the amount of insurance protection by about 25%. A new employee-paid salary continuance plan was introduced to extend disability protection beyond the maximum period of fourteen months covered by the existing non-contributory disability pay plan. The new plans have been well accepted, with 93% of eligible employees participating in the comprehensive medical expense plan and 82% participating in the group life insurance and salary continuance plans. These broadened coverages were obtained without any increase in the aggregate cost to employees or to the Company.

SEISMOGRAPH OPERATIONS
Peace River Area

In addition to the plans which were revised or introduced during the year, the security and welfare of employees are protected by retirement pay, a thrift plan, holiday and vacation pay, workmen's compensation insurance and unemployment insurance. Company contributions under all benefit plans totalled $396,000 or 15.9% of salaries and wages in 1959.

Salaries and wages of $2,488,000 were paid during the year, an increase of $294,000 over the amount paid in the preceding year. Additions to staff and a general increase of 5% in salaries and wages on January 16, 1959 were the principal reasons for this increase. At year-end the Company's staff numbered 412 employees, an increase of 16 people during the year.

FINANCIAL

Net income in 1959, exclusive of special credits, was $2,821,000 or 16 cents per share, an increase of $1,505,000 or 9 cents per share over the comparable net income for 1958. A large increase in sales of natural gas and lower dry hole costs were the principal items contributing to the improvement in net income. Special credits, arising primarily from sales of properties, raised total net income for 1959 to $3,764,000.

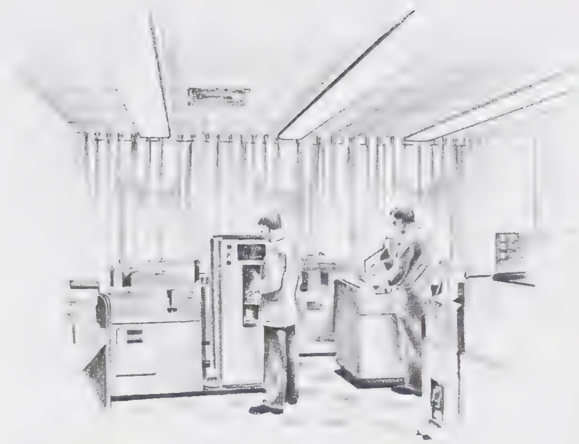
Gross operating income was $20,974,000, an increase of $1,579,000 or 8.1% over the previous year. Sales of crude oil totalling $17,351,000 were down $268,000, as lower crude oil prices more than offset the effect of a 5.2% increase in

sales volumes. Sales of natural gas at $1,902,000 were up $1,494,000, reflecting a full year's production at Cessford and other fields from which deliveries commenced in the fall of 1958. Pipe line revenue of $1,648,000 was up $353,000 as the result of an increase in the volume of crude oil transported.

Total expenses, including non-cash charges, were $18,508,000, down slightly from 1958. As discussed in the drilling section of this report, charges for dry holes were $1,075,000 less than in the previous year. Also, the provision for depletion was reduced by $104,000 as the result of lower charges per unit of production. Partly offsetting these savings, there were increases of $1,023,000 in operating and general expenses and $351,000 in the provision for depreciation. The increase in operating and general expenses primarily reflected the costs of additional conservation projects, a full year's operation of gas plants, and an increased number of wells on production. The larger provision for depreciation was necessary with the continued growth of investment in properties.

As explained in Note 3 to the financial statements, no provision for income taxes was required in 1959, and the Company has a very substantial accumulation of deductions which may be carried forward to offset taxable income of future years. It is clear that the larger portion of these deductions will be allowed, but the exact amount of the carry-forward cannot be determined pending clarification of certain features of the Income Tax Act.

The Company's expenditures for property, plant, and equipment totalled $14,679,000 in 1959, compared with $14,845,000 in 1958. As in previous years, the major part of these expenditures represented the costs of drilling and equipping new wells and of acquiring acreage. In addition to these capital outlays, exploration expenditures charged currently against income were $4,024,000 in 1959 and $4,026,000 in 1958.



DATA PROCESSING EQUIPMENT
Calgary Office

In 1959 the Company purchased $1,000,000 principal amount of its 4% First Mortgage Sinking Fund Bonds, Series A, at a substantial discount. These bonds were surrendered to the Trustee for cancellation, thereby increasing the Company's sinking fund credit to $2,000,000.

In the latter part of the year the Company took advantage of an opportunity to recover the investment in its head office building on favorable terms. The building and site were sold for $4,380,000, but control of the property was retained by simultaneous execution of a long-term lease. The lease runs for an initial term of 25 years and may be extended, at the Company's option, for two additional terms of 21 years each.

The annual net rentals are 3½% of the selling price for a minimum period of 5 years, with higher rental rates provided thereafter. HBOG has an option, also for a minimum period of 5 years, to repurchase the property at the original selling price. In view of the repurchase option and the low initial rental rate, the excess of the selling price over the depreciated cost of the property has been set up in the accounts as a deferred credit, as explained in Note 5 to the financial statements.

On December 31, 1959 Hudson's Bay Oil and Gas Company Limited issued $1,100,000 of 5% Series B and $2,500,000 of 5¾% Series C First Mortgage Sinking Fund Bonds in exchange for equal amounts of Rangeland Pipe Line Company Limited Series A and Series B Bonds. The exchange was made pursuant to an arrangement under which HBOG purchased all of the assets and assumed all of the liabilities of this wholly owned subsidiary. The new HBOG bonds have the same interest rates, maturity dates, call premiums, and sinking fund requirements as the Rangeland bonds for which they were exchanged.

The Company maintained its strong working capital position during 1959, as shown in the summary of source and use of funds given below.

SOURCE AND USE OF FUNDS

	1959	1958
Source of Funds:		
Net income before special credits	$ 2,821,000	$ 1,316,000
Non-cash charges for depletion, depreciation, dry holes, surrendered leases, and amortization of debt expense	8,260,000	9,177,000
Cash generated from operations	11,081,000	10,493,000
Sales of properties and investments	5,477,000	3,149,000
Total funds available	16,558,000	13,642,000
Use of Funds:		
Expenditures for property, plant, and equipment	14,679,000	14,845,000
Reduction of long-term debt	1,100,000	1,000,000
Miscellaneous uses (sources) of funds	(34,000)	200,000
Total funds used	15,745,000	16,045,000
Resulting Increase (Decrease):		
In cash and short-term securities	386,000	(1,684,000)
In other working capital items	427,000	(719,000)
In total working capital	$ 813,000	$(2,403,000)

Hudson's Bay Oil and Gas Company Limited

and Subsidiary Companies

CONSOLIDATED STATEMENT OF INCOME

YEARS ENDED DECEMBER 31, 1959 AND 1958

	1959	1958
Income:		
Gross operating income	$20,974,000	$19,395,000
Interest and other income	355,000	530,000
	21,329,000	19,925,000
Expenses (Note 1):		
Operating and general expenses (Note 2)	6,343,000	5,320,000
Rentals of undeveloped oil and gas properties	2,346,000	2,362,000
Taxes, other than income taxes	426,000	399,000
Dry holes and abandonments	2,210,000	3,285,000
Surrendered leases	135,000	204,000
Depletion	3,675,000	3,779,000
Depreciation	2,188,000	1,837,000
Interest and expense on long-term debt	1,185,000	1,268,000
Deferred income taxes (Note 3)	—	155,000
	18,508,000	18,609,000
Net Income before Special Credits	2,821,000	1,316,000
Special Credits, principally from sales of properties in 1959 and investments in 1958	943,000	2,472,000
Net Income for Year	$ 3,764,000	$ 3,788,000

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

YEARS ENDED DECEMBER 31, 1959 AND 1958

	1959	1958
Balance at Beginning of Year	$ 4,417,000	$ 629,000
Net Income for Year	3,764,000	3,788,000
Balance at End of Year	$ 8,181,000	$ 4,417,000

ASSETS

	1959	1958
Current Assets:		
Cash	$ 608,000	$ 757,000
Government and other securities at cost, which approximates market	10,041,000	9,506,000
Accounts receivable	5,351,000	3,905,000
Inventories of crude oil and supplies at or below average cost	1,826,000	2,176,000
Total Current Assets	17,826,000	16,344,000
Investments in Non-Controlled Companies at Cost	474,000	480,000
Property, Plant and Equipment at Cost	105,809,000	98,376,000
Less: Accumulated depreciation and depletion	26,338,000	21,295,000
	79,471,000	77,081,000
Oil and Gas Rights on Hudson's Bay Company Lands	1,000	1,000
Other Assets:		
Unamortized bond discount	481,000	527,000
Operating and performance deposits	360,000	204,000
Miscellaneous, including mortgages receivable from officers of $17,000 in 1959 and $28,000 in 1958	287,000	273,000
	1,128,000	1,004,000
	$ 98,900,000	$94,910,000

Approved on Behalf of the Board:

G. T. Pearson, DIRECTOR

L. J. Richards, DIRECTOR

LIABILITIES AND SHAREHOLDERS' EQUITY

	1959	1958
Current Liabilities:		
Accounts payable and accrued liabilities	$ 4,206,000	$ 3,631,000
Long-term debt due within one year	100,000	—
Accrued bond interest	227,000	233,000
Total Current Liabilities	4,533,000	3,864,000
Long-Term Debt (Note 4):		
Hudson's Bay Oil and Gas Company Limited:		
First Mortgage Sinking Fund Bonds:		
4% Series A, maturing May 1, 1975	23,000,000	24,000,000
5% Series B, maturing October 1, 1971, exclusive of $100,000 due within one year	1,000,000	—
5¾% Series C, maturing August 1, 1977	2,500,000	—
Rangeland Pipe Line Company Limited:		
First Mortgage Sinking Fund Bonds:		
5% Series A, maturing October 1, 1971	—	1,100,000
5¾% Series B, maturing August 1, 1977	—	2,500,000
	26,500,000	27,600,000
Deferred Credits:		
Income taxes (Note 3)	—	155,000
Re office building (Note 5)	812,000	—
	812,000	155,000
Shareholders' Equity:		
Share capital, par value $2.50 per share:		
Authorized: 25,000,000 shares		
Issued and outstanding: 17,744,592 shares	44,362,000	44,362,000
Paid-in surplus	14,512,000	14,512,000
Retained earnings	8,181,000	4,417,000
	67,055,000	63,291,000
	$98,900,000	$94,910,000

NOTES TO FINANCIAL STATEMENTS - DECEMBER 31, 1959

Note 1: The Company's accounting practice is to charge exploration expenses against income as incurred. The cost of drilling successful wells is capitalized and amortized on a unit of production basis, and the cost of unsuccessful wells is expensed upon completion.

Note 2: The following amounts were paid during the year ended December 31, 1959: Directors fees and expenses $28,000; salaries of executive officers $192,000; fees and salaries for legal counsel $42,000.

Note 3: During the last two years provision has been made in the accounts of Rangeland Pipe Line Company Limited, a wholly owned subsidiary, for income taxes which would have been payable if interest and depreciation deducted for tax purposes had not exceeded the amounts charged in the statement of income. On December 31, 1959 the assets of this company were sold to Hudson's Bay Oil and Gas Company Limited and, as a result of this transaction, provision for deferred income taxes is no longer required. Accordingly, the 1959 provision has been reversed, and the 1958 provision of $155,000 has been restored to income through special credits.

Under the provisions of the Income Tax Act and Regulations, oil companies are permitted to deduct currently the costs of drilling both successful and unsuccessful wells and also are allowed, in general, to carry forward the excess of deductions over income in any year to apply against the taxable income of future years. As a result of these provisions, Hudson's Bay Oil and Gas Company Limited had a substantial carry-forward at December 31, 1959 to use against future taxable income.

Note 4: The First Mortgage Sinking Fund Bonds of Hudson's Bay Oil and Gas Company Limited are secured under a Deed of Trust and Mortgage by a first fixed and specific mortgage and charge on certain petroleum and natural gas leases and by a first floating charge on all other property and assets of the Company, both present and future. Under the provisions of the Deed of Trust and Mortgage payments sufficient to redeem the following principal amounts of bonds are required: 4% Series A bonds — $1,000,000 in each of the years 1960 to 1974, inclusive, with the balance of $10,000,000 payable in 1975; 5% Series B bonds — $100,000 in each of the years 1960 to 1969, inclusive, with the balance of $100,000 payable in 1970 and 1971; 5¾% Series C bonds — $160,000 in each of the years 1962 to 1976, inclusive, with the balance of $100,000 payable in 1977. During 1959 the Company purchased and surrendered to the Trustee $1,000,000 of the Series A bonds which, together with prior purchases, have established a sinking fund credit of $2,000,000, which may be applied at the option of the Company against any of the sinking fund payments required for such bonds. Subject to certain restrictions and conditions, the Company may issue additional bonds secured by the Deed of Trust and Mortgage.

On December 31, 1959, Hudson's Bay Oil and Gas Company Limited purchased all of the assets and assumed all of the liabilities of Rangeland Pipe Line Company Limited, a wholly owned subsidiary. Simultaneously, the parent company issued its Series B and Series C First Mortgage Sinking Fund Bonds in exchange for the subsidiary company's Series A and Series B First Mortgage Sinking Fund Bonds, which were cancelled.

Note 5: On December 1, 1959, Hudson's Bay Oil and Gas Company Limited sold its Calgary office building and site for $4,380,000 and simultaneously entered into a long-term lease for the entire property. The lease runs for an initial term of 25 years and may be extended, at the Company's option, for two additional terms of 21 years each. Under the terms of the lease, annual net rentals are payable at a rate of 3½% of the selling price for a minimum period of 5 years and at higher rates thereafter. The Company has an option, also for a minimum of 5 years, to repurchase the property at the original selling price and to cancel the lease.

The excess of the selling price over the depreciated value of the property and a charge in lieu of depreciation since the date of sale have been recorded in the accounts as a deferred credit. The amounts accumulated in this account will be credited to the reserve for depreciation if the building is repurchased and otherwise will be credited against future rentals.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheet of Hudson's Bay Oil and Gas Company Limited and subsidiary companies as of December 31, 1959 and the consolidated statements of income and retained earnings for the year ended on that date and have obtained all the information and explanations we have required. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion (according to the best of our information and the explanations given to us and as shown by the books of the companies) the accompanying consolidated balance sheet and consolidated statements of income and retained earnings are properly drawn up so as to exhibit a true and correct view of the state of the affairs of Hudson's Bay Oil and Gas Company Limited and subsidiary companies at December 31, 1959 and the results of their operations for the year ended on that date, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
February 8, 1960

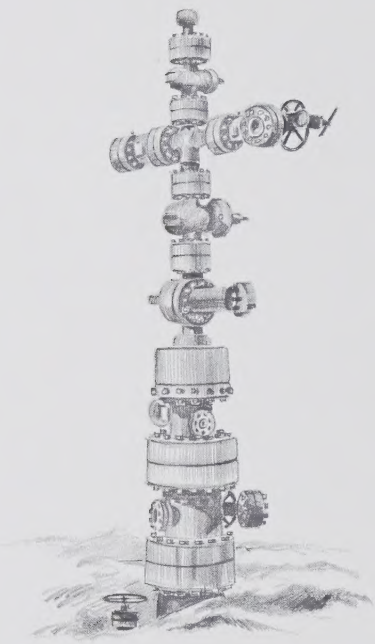
Peat, Marwick, Mitchell & Co.
Chartered Accountants

FIVE YEAR FINANCIAL AND OPERATING REVIEW (1)

		1959	1958	1957	1956	1955
Income — Financial Data	Gross operating income	$ 20,974	19,395	20,963	18,040	11,091
	Net income (loss) before special credits:					
	Total	$ 2,821	1,316	3,073	2,359	(1,059)
	Per Share	$ .16	.07	.17	—	—
	Special credits	$ 943	2,472	4,742	2,245	729
	Net income (loss) for year	$ 3,764	3,788	7,815	4,604	(330)
	Working capital	$ 13,293	12,480	15,155	1,632	(1,070)
	Current ratio	3.9	4.2	5.8	1.3	.8
	Long-term debt	$ 26,500	27,600	28,600	52,100	32,003
	Shareholders' equity	$ 67,055	63,291	59,503	12,814	8,210
Gross Property Accounts	Leases	$ 14,605	12,606	11,683	9,647	9,210
	Wells, plants and equipment	$ 83,701	75,149	66,163	53,969	34,423
	Pipe line property	$ 6,334	5,634	4,908	2,136	—
	Other	$ 1,169	4,987	4,810	4,591	3,009
	Total	$105,809	98,376	87,564	70,343	46,642
Expenditures For Finding and Developing Reserves (2)	Acreage acquisitions	$ 2,297	1,126	2,053	436	1,576
	Exploratory expenses	$ 1,678	1,664	2,246	2,272	3,165
	Lease rentals	$ 2,346	2,362	2,853	2,486	2,431
	Cost of productive wells	$ 3,657	5,102	8,596	14,200	13,373
	Cost of dry holes	$ 2,210	3,285	1,436	1,724	1,483
	Plants and equipment	$ 5,661	4,374	3,606	5,118	3,922
	Total	$ 17,849	17,913	20,790	26,236	25,950
Net Crude Oil Production	Average barrels daily	21,144	20,099	22,257	20,992	13,152
	Alberta	19,058	17,953	20,097	19,194	11,700
	Saskatchewan	2,026	2,117	2,144	1,796	1,450
	Other provinces	60	29	16	2	2
	Annual barrels (thousands)	7,718	7,336	8,124	7,683	4,801
Net Natural Gas Sales	Millions of cubic feet daily	47.915	14.364	8.109	6.118	5.370
	Billions of cubic feet annually	17.489	5.243	2.960	2.239	1.960
Wells	Completed					
	Gross wells	185.0	192.0	184.0	335.0	318.0
	Net wells	101.3	102.2	107.7	186.2	174.0
	Net development wells	74.4	71.9	74.8	153.4	156.6
	Oil wells	62.9	55.8	65.4	149.2	154.1
	Gas wells	6.4	9.3	5.1	.8	—
	Dry holes	5.1	6.8	4.3	3.4	2.5
	Net exploratory wells	26.9	30.3	32.9	32.8	17.4
	Oil wells	3.5	2.0	3.6	6.6	5.5
	Gas wells	1.5	5.3	7.3	4.5	3.5
	Dry holes	21.9	23.0	22.0	21.7	8.4
	Capable of production					
	Total wells	677.0	620.0	596.6	513.4	357.5
	Oil wells	605.8	552.9	543.0	474.5	322.6
	Gas wells	71.2	67.1	53.6	38.9	34.9
Net Acreage	Thousands of acres	11,542	10,147	10,461	10,948	9,445
	Fully or partially developed	135	125	100	88	64
	Undeveloped	11,407	10,022	10,361	10,860	9,381
	Number of shareholders	12,171	12,738	12,941	2	2
	Number of employees	412	396	356	307	251

(1) The figures in this table are for Hudson's Bay Oil and Gas Company Limited and subsidiary companies at December 31 or for years then ended. With the exception of earnings per share, dollar figures are in thousands.

(2) Includes both capital and expense items; excludes interest and administrative expense.



"CHRISTMAS TREE"
Natural Gas Well
Beaver Creek Field

LITHOGRAPHED IN CANADA